Cabinet – 18 December 2019

Treasury Management Mid-Year Position Statement 2019/20

Portfolio: Councillor Bird, Leader of the Council

Related portfolios: N/A

Service: Finance

Wards: All

Key decision: No

Forward plan: Yes

1. Aim

1.1 The council is required through regulations issued under the Local Government Act 2003 to produce a mid-year position statement reviewing treasury management activities and prudential and treasury indicator performance. The treasury management mid-year position statement at Appendix A provides Cabinet with these details, and meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

2. Summary

2.1. This report sets out the council's 2019/20 mid-year position statement for treasury management activities (Appendix A) and a summary of performance against set targets (Appendix B).

2.2. Despite difficult market conditions with low interest rates the net position for capital financing is expected to overachieve against budget by £1.038m. This has currently been assumed to be transferred to reserves to support known changes in investment returns going forward.

3. Recommendations

3.1 To note and forward to Council, for consideration and noting (and in line with the requirements of the Treasury Management Code of Practice (2017)), the mid-year position statement for treasury management activities 2019/20 including prudential and local indicators (Appendix A).

4. Report detail - know

Context

4.1 Each year the council operates a balanced budget, which broadly means cash raised during the year will meet its expenditure. Part of the treasury management service is to ensure this cash flow is adequately planned, with surplus monies being invested in line with the Treasury Management Policy Statement, which was approved by Council in February 2019.

Another function of the treasury management service is the funding of the Council's capital programme. This function highlights any potential borrowing requirement which may involve arranging long or short term loans, or using longer term cash flow surpluses.

The following key points of interest have been extracted from the report at Appendix A:

- The mid-year position statement meets the requirement of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities.

- The banking environment has continued to be one of low interest returns with some improved confidence in counter party risk. The base rate remained static at 0.75% for the period 1 April until 30 September 2019.

- Despite this situation the authority has continued to identify appropriate new areas of investment opportunity that has led to a significant impact on average investment performance which increased from 1.37% in 2018/19 to 1.47% in 2019/20. An overachievement of investment income is expected to be approximately £400k as a result of the average rate achieved across all investments being higher than budgeted for in the 2019/20 budget setting exercise. This has taken considerable effort and negotiation from the treasury team to secure favourable rates when considering investment options, and through the review and identification of new opportunities for investment.

Council Corporate Plan priorities

4.2 Sound financial management of the council's cash balances supports the delivery of council priorities within the council's available resources.

Risk management

4.3 Treasury management activity takes place within a robust risk management environment, which enables the council to effectively maximise investment income and minimise interest payments without undue or inappropriate exposure to financial risk. It is recognised that the management of risk is as important as maximisation of performance and it is essential that the council has the right balance of risk and reward when making investment decisions. This is supported by treasury management policies which seek to manage the risk of adverse fluctuations in interest rates and safeguard the financial interests of the council.

4.4 Brexit continues to provide uncertainty for interest rates and within the financial markets and is expected to continue until at least the 31/01/20 deadline. The council has responded to this risk by reviewing counterparties for investments to minimise the risk to any one counter party or class of counter party, and entering into fixed term investment deposits that mature after the 31/01/20 Brexit deadline to minimise interest rate risk.

Financial implications

4.5 Treasury management activity forms part of the council's financial framework and supports delivery of the medium term financial strategy. The review of treasury management performance and activity is reviewed through both the treasury management annual report and the mid-year performance review report.

Legal implications

4.6 The council is required to have regard to the Prudential Code under the duties outlined by the Local Government Act 2003. One requirement of the Prudential Code is that the council should comply with the CIPFA Code of Practice for Treasury Management. The council adopted the original treasury management code in 1992 and further revisions to the Code in 2002, 2010 and 2017.

Procurement Implications/Social Value

4.7 None directly relating to this report.

Property implications

4.8 None directly relating to this report.

Health and wellbeing implications

4.9 None directly relating to this report.

Staffing implications

4.10 None directly relating to this report.

Reducing Inequalities

4.11 None directly relating to this report.

Consultation

4.12 The report has been approved by the finance treasury management panel, an internal governance arrangement comprising the S151 Officer, Head of Finance (Deputy S151 Officer) and Deputy Head of Finance (Corporate).

5. Decide

5.1 In line with the Treasury Management Code of Practice (2017) there are a number of reports that are required to be produced and reported publicly each year. The treasury management mid-year position statement forms one of these requirements and as such is being reported to Cabinet for noting and forwarding onto Council for consideration.

6. Respond

6.1 This report is not seeking approval of a decision, in line with the Treasury Management Code of Practice (2017) it is required to be reported for noting and forwarding to Council for consideration.

7. **Review**

7.1 In line with Treasury Management Code of Practice (2017) this is a backward looking document looking at performance over the first six months of the current financial year and a further report on performance will be provided each year in line with the requirements of the Code.

Background papers

Various financial working papers

Corporate Budget Plan and Treasury Management and Investment Strategy 2019/20 (including Treasury Management Policy Statement) – Council 28/02/19

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James Walsh
Executive Director –
Resources and Transformation (S151 Officer)
10 December 2019

Councillor M. Bird
Leader of the Council
10 December 2019

Appendix A

Treasury Management Mid-Year Review

Table 1 shows borrowing and investments held at 31 March 2019 and 30 September 2019. The table shows that net borrowing during this period have broadly remained the same.

The forecast borrowing position for the year end shows an approximat21m reduction in overall borrowing levels linked predominantly to the repayment of loan maturities in December 2019 for loans taken out to meet the cash flow requirements for the upfront pension payment made in April 2017.

The investment balance for the period to 30 September 2019 has increased by approximately £36m; this is in line with the budgeted assumptions for the year which included a plan to ensure that cash balances were maintained at an appropriate and robust level in line with expected cash flows projected for the year. This is also linked to the cash flow profile for local authorities where a large proportion of income is normally received at the start of the year (with upfront payment of grants / council tax / business rates etc), with corresponding expenditure normally being spread across the year.

The forecast investment position for the year end shows that investment balances are expected to decrease as we approach 31 March 2020 and payments on capital schemes are made and less income is profiled to be raised, and therefore collected, during the period.

Table 1

Borrowing	31-Mar-19	30-Sep-19	Change in year	Forecast Position 31-Mar-20	Forecast Change 31-Mar-19 to 31-Mar-20
	£m	£m	£m	£m	£m
PWLB	175.530	175.530	0.000	175.530	0.000
Private Loans	95.000	95.000	0.000	95.000	0.000
Other Loans	32.223	32.221	(0.002)	11.030	(21.193)
Total Borrowing	**302.753**	**302.751**	**(0.002)**	**281.560**	**(21.193)**
Investments	**31-Mar-19**	**30-Sep-19**	**Change in year**	**Forecast Position 31-Mar-20**	**Forecast Change 31-Mar-19 to 31-Mar-20**
	£m	**£m**	**£m**	**£m**	**£m**
At-call	24.360	24.498	0.138	20.000	(4.360)
Short term	102.500	135.000	32.500	98.000	(4.500)
Long term	15.000	18.000	3.000	15.000	0.000
Property funds	20.000	20.000	0.000	20.000	0.000
Total Investments	**161.860**	**197.498**	**35.638**	**153.000**	**(8.860)**
Net Position (Borrowing less Investment)	**140.893**	**105.253**	**(35.640)**	**128.560**	**(12.333)**

Capital Financing

Table 2 below shows the midyear revenue outturn forecast for treasury management capital financing. The net forecast underspend of £1.038m has currently been assumed to be transferred to reserves (interest payable line) to support known changes in investment returns going forward. This is in the main attributable to the forecast overachievement of investment income returns of (£0.400m) due to ongoing proactive management of cash flow, and the identification of appropriate counterparty investment options. There is a further (£0.715m) underspend on interest payable costs due to borrowing at favourable interest rates compared to budget, and delaying borrowing for the 2018/19 capital programme as a result of sufficient liquidity. Notable pressures include a £90k forecast on Other Local Authority Debt following an update to the interest rate used in the calculation in line with the original agreement. In line with a review of the Minimum Revenue Provision (MRP) that was undertaken during 2015/16 the charge for 2019/20 is £4.007m over budget with a corresponding release from reserves.

Table 2

Service Description	Full Year Forecast	Annual Budget	Forecast Variance	Transfer (from) / to reserves	Net Forecast Variance
	£m	£m	£m	£m	£m
Interest Payable	10.628	11.343	(0.715)	1.038	0.323
Investment Returns	(2.811)	(2.411)	(0.400)	0.000	(0.400)
Allocation of interest on internal balances	0.035	0.035	0.000	0.000	0.000
Other Local Authority Debt	2.110	2.021	0.089	0.000	0.089
Treasury Management costs	0.029	0.020	0.009	0.000	0.009
Bank charges	0.100	0.121	(0.021)	0.000	(0.021)
Birmingham Airport	(1.465)	(1.465)	0.000	0.000	0.000
Mortgages	0.000	0.000	0.000	0.000	0.000
Minimum Revenue Provision	13.260	9.253	4.007	(4.007)	0.000
Total	**21.886**	**18.917**	**2.969**	**(2.969)**	**0.000**

Economic Context

2019 has been a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU has agreed an extension to 31 January 2020. In addition, a general election has been called for 12 December. Given the uncertainty about the result of the general election and what MPs could afterwards decide, any interest rate forecasts are subject to material change as this situation evolves. If Parliament agrees to a deal on 31 January then it is possible that growth could recover relatively quickly. The MPC could then need to address the issue of whether to raise Bank Rate at some point in the coming year when there is little slack left in the labour market that could cause wage inflation to accelerate; this would then feed through into general inflation. On the other hand, if there was a no deal Brexit and there was a significant level of disruption to the economy, then growth could weaken even further than currently: the MPC would then be likely to cut Bank Rate in order to support growth. However, with Bank Rate still only at 0.75%, the MPC has relatively little room to make a big impact and it would probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction. It also has to be borne in mind that even if a deal is agreed on 31 January 2020, the current transition period for negotiating a trade deal only runs until 31 December 2020. This could prove to be an unrealistically short timetable for such major negotiations which leaves open two possibilities; one the need for an extension of negotiations, probably two years, or a no deal Brexit in December 2020.

As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell to 1.7% in August. It is likely to remain close to 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time. However, if there was a no deal Brexit, inflation could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

With regard to the labour market, despite the contraction in quarterly GDP growth of -0.2%q/q, (+1.3% y/y), in quarter 2, employment continued to rise, but at only a muted rate of 31,000 in the three months to July after having risen by no less than 115,000 in quarter 2 itself: the latter figure, in particular, suggests that firms are preparing to expand output and suggests there could be a return to positive growth in quarter 3. Unemployment continued at a 44 year low of 3.8% on the Independent Labour Organisation measure in July and the participation rate of 76.1% achieved a new all-time high. Job vacancies fell for a seventh consecutive month after having previously hit record levels. However, with unemployment continuing to fall, this month by 11,000, employers will still be having difficulty filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9% in June before easing back slightly to 3.8% in July, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The latest GDP statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not over stretched and so will be able to support growth going forward. This would then mean that the MPC will need to consider carefully at what point to take action to raise Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020.

Performance

The prudential and local indicators as at 30 September 2019 are shown in **Appendix B.** All indicators are currently being met with the exception of L8 – average interest rate received on short term interest vs. the 7 day London Interbank Bid Rate (LIBID). A target for 2019/20 was set based on economic conditions during 2018/19 and expectations for 2019/20. Whilst not currently at a target of 75 basis points over LIBID the council is achieving 67 basis points over LIBID and expects this to be consistent for the remainder of the year.

The targets that these prudential indicators are monitored against have been taken from the Treasury Management and Investment Strategy for 2019/20 Onwards, which was approved by Council in February 2019.

Appendix B

Prudential Indicators as at 30th September 2019

<table>
<tr><th colspan="2" rowspan="2">Prudential Indicator</th><th rowspan="2">Actual
2018/19
£m</th><th rowspan="2">Target
2019/20
£m</th><th rowspan="2">Forecast Position at
31-Mar-20
£m</th><th colspan="2">Variance to target</th></tr>
<tr><th>Numerical Variance</th><th>% Variance</th></tr>
<tr><td>PrI 1</td><td>Capital Expenditure</td><td>57.073</td><td>119.800</td><td>97.360</td><td>-22.440</td><td>-19%</td></tr>
<tr><td colspan="7">This indicator is required to inform the council of capital spending plans it is the duty of a local authority to determine and keep under review the amount that it can afford to allocate to capital expenditure. Capital expenditure may be funded by grant, capital receipts and borrowing. The forecast variance to target for 2019/20 is due to re profiling of capital schemes.</td></tr>
<tr><td>PrI 2</td><td>Ratio of financing costs to net revenue stream</td><td>4.46%</td><td>4.32%</td><td>4.30%</td><td>-0.02%</td><td>-1%</td></tr>
<tr><td colspan="3">Financing costs - Divided by
(Interest charged on loans Less Interest earned on investments)</td><td colspan="2">Budget requirement
(Revenue Support Grant + NNDR +Council Tax)</td><td colspan="2">The ratio of financing costs to net revenue stream (General Fund) as a %</td></tr>
<tr><td>PrI 3</td><td>Estimates of the incremental impact of new capital investment decisions on Council Tax</td><td>£24.14</td><td>£15.36</td><td>£15.36</td><td>0.00</td><td>0%</td></tr>
<tr><td colspan="7">This is a notional amount indicating the amount of council tax band D that is affected by the capital programme in the budget report compared to existing approved commitments and current plans.</td></tr>
<tr><td>PrI 4</td><td>Capital Financing Requirement</td><td>357.672</td><td>381.564</td><td>381.564</td><td>0.00</td><td>N/A</td></tr>
<tr><td colspan="7">This represents the underlying level of borrowing needed to finance historic and future capital expenditure. It is updated at end of the financial year.</td></tr>
<tr><td>PrI 5</td><td>Authorised Limit for external debt</td><td>442.096</td><td>458.391</td><td>458.391</td><td>0.00</td><td>0%</td></tr>
<tr><td colspan="7">The council may not breach the limit it sets, so it is important to allow prudent room for uncertain cash flow movements and borrowing in advance of future need.</td></tr>
<tr><td>PrI 6</td><td>Operational Limit for external debt</td><td>401.905</td><td>416.719</td><td>416.719</td><td>0.00</td><td>0%</td></tr>
<tr><td colspan="7">This has been set at the level of the capital financing requirement less the CFR items relating PFI and finance leases.</td></tr>
</table>

PrI 7	**Gross Borrowing exceeds capital financing requirement**	**No**	**No**	**No**	
The CFR represents the underlying level of borrowing needed to finance historic capital expenditure. Actual net borrowing should be lower than this because of strong positive cash flow and balances. It would be a cause for concern if net borrowing exceeded CFR.					
PrI 8	**Authority has adopted CIPFA Code of Practice for Treasury Management**	**Yes**	**Yes**	**Yes**	
To ensure that treasury management activity is carried out within best professional practice**.**					
PrI 9	**Total principle sums invested for longer than 364 days must not exceed**	**15.0**	**25.0**	**13.0**	
The council is at risk when lending temporarily surplus cash. The risk is limited by investing surplus cash in specified investments and by applying lending limits and high credit worthiness. These are kept under constant review.					

Prudential Indicator continued		**Upper Limit**	**Lower Limit**	**Actual 2018/19**	**Forecast Position at 31-Mar-20**
PrI 10	Fixed Interest Rate Exposure	95.00%	40.00%	**93.51%**	**93.51%**
PrI 11	Variable Interest Rate Exposure	45.00%	0.00%	**6.49%**	**6.49%**
PrI 12	***Maturity Structure of Borrowing***				
	Under 12 months	25.00%	0.00%	**12.91%**	**12.91%**
	12 months and within 24 months	25.00%	0.00%	**4.87%**	**6.49%**
	24 months and within 5 years	40.00%	0.00%	**26.41%**	**24.78%**
	5 years and within 10 years	50.00%	5.00%	**8.20%**	**8.20%**
	10 years and above	85.00%	30.00%	**47.61%**	**47.62%**

Local Indicators as at 30th September 2019

Local Indicators		Actual 2018/19	Target 2019/20	Forecast Position as at 31-Mar-20	Variance to target		Met
					Numerical Variance	% Variance	
L1	**Full compliance with prudential code**	**Yes**	Yes	**Yes**	-	-	Y
L2	**Average length of debt**	**18.37**	Lower Limit 15 years, Upper limit 25 years	**18.04**	-	-	Y
This is a maturity measure and ideally should relate to the average lifespan of assets.							
L3a	**Financing costs as a % of council tax requirement**	**6.54%**	20.00%	**6.32%**	-13.68%	-68.39%	Y
L3b	**Financing costs as a % of tax revenues**	**4.06%**	12.50%	**3.94%**	-8.56%	-68.49%	Y
These are a variation to PrI 3 excluding investment income and including MRP (amount set aside to repay debt costs). The target figure of 12.5% represents an upper limit of affordable net borrowing costs as a percentage of tax revenues for the authority. The actual level of net borrowing costs is currently less than the upper limit, which in the main is linked to the work undertaken by the service to seek to secure favorable rates on investments and reduced costs on borrowing, thus reducing the overall net borrowing costs.							
L4	**Net actual debt vs. operational debt**	**75.20%**	85.00%	**72.53%**	-12.47%	-14.67%	Y
This assists the monitoring of the authority's debt position.							
L5	**Average interest rate of external debt outstanding excluding OLA**	**3.69%**	3.69%	**3.69%**	0.00%	-0.00%	Y
L6	**Average interest rate of external debt outstanding including OLA**	**3.83%**	3.93%	**3.83%**	-0.10%	-2.43%	Y
The measure should be as low as possible. Other Local Authority debt (OLA) is managed on our behalf by Dudley council.							

L7	**Gearing effect of 1% increase in interest rate**	**3.89%**	5.00%	**3.89%**	**0.06%** **This would increase the average interest rate payable from 3.83% shown in L6 to 3.89%**		**Y**
This relates risk management principles to the monitoring of the TM strategy. It measures the effect of a change in interest rates and the effect it may have on the capital financing costs.							
L8	**Average interest rate received on STI vs. 7 day LIBID rate**	**0.77%**	0.75%	**0.67%**	-0.08%	-10.47%	**N**
The council aims to be gain interest on surplus funds higher than the 7 day LIBID rate. This measures performance in a changing economic context.							
L9a	**AT call investments**	**0.55%**	0.60%	**0.67%**	0.07%	11.67%	**Y**
L9b	**Short Term Investments**	**1.09%**	1.10%	**1.24%**	0.14%	12.73%	**Y**
L9c	**Long Term Investments**	**1.37%**	1.40%	**1.62%**	0.22%	15.71%	**Y**
L10	**Average interest rate on all ST investments (ST and AT call)**	**0.98%**	1.04%	**1.13%**	0.09%	8.65%	**Y**
L11	**Average rate on all investments (ex. Property fund)**	**1.05%**	1.08%	**1.20%**	0.12%	11.11%	**Y**
L11a	**Average rate on all investments (inc. property fund)**	**1.37%**	1.45%	**1.47%**	0.02%	1.38%	**Y**
As L10, but includes investments longer than 364 days. All of the 7 indicators within L9-L11 are currently being exceeded. This is in the main due to the ongoing negotiations being undertaken by the service to secure favourable rates when considering investment options, and through the review and identification of new and appropriate opportunities for investment.							
L12	**% daily bank balances within target range**	**100%**	99%	**100%**	1.00%	1.01%	**Y**
This measures how good our daily cash flow prediction is. A figure of 98% and above indicates a high level of accuracy.							